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Via Electronic Delivery and Facsimile

The Honorable Michael K. Powell
Chairman
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: *SBC's Proposal for the Development of a Sustainable Wholesale Model*

Dear Chairman Powell:

On November 18, 2002, SBC put forward a proposal that could serve as a national framework by which incumbent LECs and CLECs effect a smooth transition from the UNE-platform to a more sustainable and rational wholesale business model. Specifically, SBC proposed that, after finding that incumbents need not provide local switching as an unbundled network element, the Commission establish a transition plan under which incumbents would be required to make available the functional equivalent of the UNE-P for two years for use by CLECs in serving residential customers.[1] SBC proposed that this offering be priced at $26 per month per line – a rate that would: (1) cover incumbents' operating expenses (as documented in ARMIS); and (2) enable CLECs to earn reasonable margins on residential retail service.[2] Existing UNE-P customers would be transitioned to the $26 rate over a 12-month period. The two-year transition period would provide ample time for the business-to-business negotiations and the deployment of facilities necessary to avoid any concerns about disruption in the residential market.

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[1] In order to give states incentives to address below-cost residential retail rates that inhibit real competition, SBC proposed that incumbents be required to offer the UNE-P equivalent for an additional year in any state that appropriately rationalizes or deregulates residential retail rates.

[2] In a December 11, 2002, *ex parte* letter from James C. Smith, Senior Vice President, SBC, to Marlene Dortch, Secretary, FCC, SBC showed that the $26 rate SBC proposed would permit CLECs to earn margins of 15% to 34% for the customers they typically serve – and higher margins when serving the heaviest users of vertical features and long distance services.

We write now to underscore that the Commission unquestionably has the authority under section 201(b) of the Act to adopt this proposal. As an initial matter, the Commission has repeatedly, in the context of the 1996 Act and otherwise, established transition mechanisms to minimize industry disruption when new regulatory policies are put into place. It did so, for example, in the *ISP Reciprocal Compensation Declaratory Ruling* "to avoid a 'flash cut' to a new compensation regime that would upset the legitimate business expectations of carriers and their customers." 16 FCC Rcd 9151, ¶¶ 77-88 (2001). It did so, as well, in the *Local Competition Order,* when, in order to prevent any adverse impact of the unbundling regime on universal service, it required carriers who purchased unbundled local switching and used that element to originate or terminate interstate traffic, temporarily to pay certain non-cost-based access charges. *See Local Competition Order*, 11 FCC Rcd 15499, ¶¶ 716-732 (1996) (*See also Supplemental Order Clarification*, 15 FCC Rcd 9587, ¶¶ 7, 18 (2000) (interim limitations on EELs, pending further analysis, to prevent disruption to access charge and universal service regimes, as well as to facilities-based competitive special access providers); *CLEC Access Charge Order*, 16 FCC Rcd 9923, ¶¶ 37, 45 (2001) (interim benchmark standard for CLEC access charges to prevent disruption to business expectations of CLECs).

The courts uniformly have upheld the Commission's authority to establish these transitional or interim regimes. *See, e.g., MCI Telecomms. Corp. v. FCC*, 750 F.2d 135, 140 (D.C. Cir. 1984); *Capital Cities/ABC, Inc. v. FCC*, 29 F.3d 309, 316 (7th Cir. 1994); *Southwestern Bell Tel. Co. v. FCC*, 153 F.3d 523, 538-39, 550 (8th Cir. 1998). Moreover, in a wide variety of contexts, the courts have upheld the specific interim rules that the Commission has issued pursuant to this authority. *See, e.g., ACS of Anchorage, Inc. v. FCC*, 290 F.3d 403, 410 (D.C. Cir. 2002) (treatment of calls to Internet service providers for separations purposes); *Bachow Communications, Inc. v. FCC*, 237 F.3d 683, 686-87 (D.C. Cir. 2001) (allocation of fixed wireless communications licenses); *Community Television, Inc. v. FCC*, 216 F.3d 1133, 1142 (D.C. Cir. 2000) (migration of television broadcasters from analog to digital technology), *cert. denied*, 531 U.S. 1071 (2001); *Competitive Telecomms. Ass'n v. FCC*, 117 F.3d 1068, 1073-75 (8th Cir. 1997) (upholding transitional rules adopted in the *Local Competition Order*); . *Competitive Telecomms. Ass'n v. FCC*, 309 F.3d 8, 14-16 (D.C. Cir. 2002).

Inherent in the Commission's authority to establish interim or transitional *rules* is its authority to establish interim or transitional *rates*. *See e.g., ISP Remand Order.* Section 201(b) confers on the Commission broad authority "to prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this Act." Nothing in that provision limits the Commission's authority with respect to rates. Indeed, a transitional rate is often the most effective means by which to implement a glide path from one regulatory/pricing regime to another. The Commission, therefore, has ample authority to establish interim rates as necessary to ensure that its removal of UNEs pursuant to its authority under sections 251(c)(3) and 251(d)(2) is effected in a way that is consistent with the public interest and the overarching goals of the Act.

To be sure, section 252(d)(1) of the Act gives the states authority to set rates, consistent with the FCC's rules, for network elements that must be provided pursuant to section 251(c)(3).

But once the Commission removes a network element from the list of UNEs, section 252(d)(1) – and the ratemaking authority it confers on the states - no longer applies with respect to that element. *UNE Remand Order,* 15 FCC Rcd 3696, ¶¶ 468-473 (1999). Thus, neither section 252(d)(1), nor any other provision of the Act for that matter, precludes the Commission from establishing transitional rates for network elements that are removed from the list of UNEs. To the contrary, section 201(b) expressly confers on the Commission the authority to ensure that its unbundling decisions are implemented in ways that are consistent with the public interest and the goals of the Act.[3]

Nor does it matter that SBC proposes a transitional rate for the UNE-P, as opposed to pure switching. As a practical matter, unbundled switching has never been purchased by itself. Rather, it is used only as part of the UNE-P. Because the very point of a transition mechanism is to minimize industry disruption, it is entirely appropriate for the Commission to establish a transition that addresses the way in which switching actually is used by CLECs.

While the Commission thus has clear authority under section 201 to require interim offerings at interim rates to avoid a flash cut to a new unbundling regime, the Commission also could rely on section 271 as an additional source of such authority, at least with respect to the Bell operating companies. The Commission already has stated that it has authority under section 201(b) and 202(a) to "decide what prices, terms, and conditions apply" to section 271 checklist items that are not required under section 251. *UNE Remand Order,* 15 FCC Rcd 3696, ¶¶ 468-473 (1999). *See also Texas 271 Order*, 15 FCC Rcd 18354, ¶ 348 (2000) ("Checklist item obligations that do not fall within a BOC's UNE obligations, however, still must be provided in accordance with sections 201(b) and 202(a), which require that rates and conditions be just and reasonable, and not unreasonably discriminatory.) Moreover, the Supreme Court has made clear that the Commission's section 201 authority extends to all provisions of the Act, including section 271. *AT&T Corp. v. Iowa Utilities Bd.,* 525 U.S. 366, 378 (1999). The Commission thus could require Bell operating companies to implement SBC's proposed UNE-P equivalent offering by invoking its section 201 authority to implement the section 271 checklist.

As detailed in our previous filings, SBC's proposed $26 UNE-P-equivalent represents a fair and balanced approach for transitioning away from the UNE-P. During the two (or three) year period in which this rate would be available, CLECs would have sufficient time to negotiate leasing arrangements with incumbents, migrate their customers to resale, or begin to provide the

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[3] Establishing a transitional rate for a UNE-P equivalent in no way implicates the authority of states to regulate rates for local services. For one thing, the UNE-P equivalent is not a service; it is a *facilities* offering. Moreover, the facility that is made available can be used, not just for intrastate calls, but also for the origination and termination of *interstate* calls. Thus even assuming *arguendo* that the Commission lacks authority to supplant traditional state powers when implementing the 1996 Act -- a proposition that the United States Supreme Court has squarely addressed and rejected (*see AT&T Corp. v. Iowa Utilities Bd.,* 525 U.S. 366, 378 (1999)) – the Commission would *still* have authority to establish a rate for a transitional UNE-P equivalent because the facility at issue would be a mixed use facility, not a purely intrastate one.

facilities-based service that CLECs for six years have claimed will result from the UNE-P, but which has proved to be nothing more than a myth. The $26 transitional rate would also enable SBC and other incumbents to recover their operating costs. That rate is based on ARMIS costs for providing POTS service and is consistent, as well, with the estimate of AT&T's current CEO of Pacific Bell's actual costs of providing basic, residential, local service.[4] Adoption of SBC's proposal will thus reduce the disincentives to invest in facilities that excessive unbundling has created for incumbents and competitors alike, while addressing any concerns about the disruptions to the residential market that would result from a flash cut to the regime of limited unbundling mandated by the Telecommunications Act of 1996. It is well within the Commission's authority and should be adopted.

Sincerely,

Gary L. Phillips

cc: Commissioner Copps
Commissioner Abernathy
Commissioner Martin
Commissioner Adelstein
Christopher Libertelli
Jordan Goldstein
Matthew Brill
Dan Gonzalez
Lisa Zaina
John Rogovin
William Maher
Michelle Carey
Thomas Navin
Brent Olson

[4] *See* David W. Dorman, *Telecom's Tragic Reform Tale*, Upside (Mar. 16, 1998).